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IN THE SUPREME COURT OF IOWA

Supreme Court No. 19-1790

TRACY BARKALOW, TSB HOLDINGS, L.L.C. and BIG TEN PROPERTY MANAGEMENT, LLC,
Plaintiffs/Appellees/Cross-Appellants,
v.
BRYAN CLARK, JEFFREY CLARK,
Defendants-Appellants/Cross-Appellees,
And JOSEPH CLARK,
Defendant/Cross-Appellee.

BRYAN CLARK AND JEFFREY CLARK,
Counterclaim Plaintiffs/Appellants/Cross-Appellees,
v.
TRACY BARKALOW,
Counterclaim Defendant/Appellees/Cross-Appellant.

APPEAL FROM THE IOWA DISTRICT COURT
FOR JOHNSON COUNTY NO. LACV 079040
HONORABLE PAUL D. MILLER

DEFENDANTS-APPELLANTS'/CROSS-APPELLEES' FINAL REPLY BRIEF

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III. Whether the cross-appeal is without merit because the court properly denied dissolution based on oppression by the Clarks where Barkalow was the oppressor and the Clarks breached no fiduciary duties

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ARGUMENT

I. DISSOLUTION: The Court erred in ordering dissolution because the Company was not deadlocked and was operating to achieve its purposes

The arguments raised by Tracy Barkalow ("Barkalow") and Joe Clark ("Joe") should be rejected. Despite Barkalow's dysfunctional personal relationships, the profitable entity was functioning as intended and its governing documents provided a method to avoid deadlock.

A. The cases cited by the Appellees do not apply to this case because Outside Properties was not deadlocked

All of the cases cited by Barkalow and Joe involved deadlock in governance between two owners, a fact not present here. *See Kirksey v. Grohmann*, 754 N.W.2d 825, 831 (S.D. 2008) (finding that the company was "deadlocked" in its management with no ability to break ties); *Vila v. BVWebTies LLC*, No. CIV.A. 4308-VCS, 2010 WL 3866098, at *7 (Del. Ch. Oct. 1, 2010) ("When two coequal owners … are deadlocked… and the LLC Agreement provides no mechanism by which to break the deadlock…."); *Phillips v. Hove*, No. CIV.A. 3644-VCL, 2011 WL 4404034, at *25 (Del. Ch. Sept. 22, 2011) (same as *Vila*); *Gagne v. Gagne*, 338 P.3d 1152, 1156 (Col. Ct. App. 2014) (finding a "genuine issue of material fact as to whether there is a deadlock between Paula and Richard….") *Id* at 1162; *Fakiris v. Gusmar Enterprises*, LLC, New York Supreme Court, Queens County No. 14652/14, 2016 WL 6882889, at *2-3 (N.Y. Sup. Ct. November 21, 2016)

("Plaintiff Marina and defendant Kostas have equal votes in the company and cannot agree on such fundamental matters…."); *Rand, Algeier, Tosti & Woodruff v. Braun*, No. L-2833-02, 2011 WL 4862136, at *5-8 (N.J. Sup. Ct. Oct. 14, 2011) ("Joshua and Novin testified that Montview was deadlocked.") *Donovan v. Quade*, 830 F.Supp.2d 460, 489 (N.D. Ill. 2011) ("The deadlock has prevented Donovan and Quade from operating … at a profit.").

Here, the court made no finding of deadlock. The court recited multiple votes of the membership where the majority prevailed. (V.I.App. 274-276, Ruling.)

The only witness who was asked about deadlock was Bryan Clark ("Bryan") who testified: "I don't think we had deadlock before." Vol.IV-180:11[1]. "I don't remember there being any kind of deadlock as far as, you know, two voting yes, two voting no. I think for the most part we always came to some conclusion through voting." Vol.V-25:5-8. Bryan testified that Outside Properties would not be deadlocked going forward. Vol.IV-180:1-16.

Barkalow filed this action claiming that the majority vote was oppressive to the minority. This claim is the opposite of deadlock because it alleges that the majority vote prevailed. Outside Properties was not deadlocked.

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[1] Each reference to "Vol.[I, II, III, IV or V]" refers to the Trial Transcript Volume.

B. The dysfunction in certain relationships was not a deadlock

Both Appellee Briefs recite findings of "long-time acrimonious, bitter, and toxic relationship" between Barkalow on one side and Jeff Clark ("Jeff") and Bryan on the other. (V.I.App. 298, Ruling.) The court added that: "[T]he parties' relationships have gone beyond the dislike phase, and are clearly dysfunctional." (V.I.App. 296, Ruling.)

The term "toxic relationship" may have originated in the 1995 book *Toxic People*, by Dr. Lilian Glass, who describes herself as the "Queen of Communication."[2] The term appears in 29 Iowa appellate opinions relating to custody, parental rights or marriage dissolution, with one case about defamation suit between a brother and sister. *See e.g.*, *In re J.R.*, 807 N.W.2d 158 (Iowa Ct. App. 2011); *In Interest of C.C.*, 902 N.W.2d 592 (Iowa Ct. App. 2017).

The term "dysfunctional relationship" also appears in literature on psychology and communications. *See e.g.*, *What is a Dysfunctional Relationship*, Dr. Tina B. Tessina.[3] That phrase appears in 32 Iowa appellate opinions all of which relate to custody, parental rights or marriage dissolution. *See, e.g.*, *In re Q.A.S.*, 839 N.W.2d 677 (Iowa Ct. App. 2013); *In re Marriage of Boomgarden*, 789 N.W.2d 164 (Iowa Ct. App. 2010).

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[2] *Toxic People*, L. Glass PhD (Your Total Image Publishing 1995) p. 16; https://www.drlillianglass.com/

[3] http://www.tinatessina.com/dysfunctional_relationship.html

There are no appellate cases in Iowa using the phrases “toxic relationship” or “dysfunctional relationship” applied to the dissolution of business entities. The Iowa cases and the literature from popular psychology generally use these terms to refer to interpersonal relationships.

The Barkalow relationships were dysfunctional, but Outside Properties was functioning in accordance with its purposes as recited below. Moreover, Barkalow was sole source of the misconduct as recited below. There was no dysfunction in the relationships between Jeff, Bryan and Joe. There was no evidence of acrimony, bitterness or toxicity in the relationships between those three, who constituted the majority in the membership votes. The LLC conducted membership meetings and the members took votes (often 3 to 1) even at the height of the acrimony with Barkalow. (V.I.App. 274-276, Ruling.)

There is a distinction between the decisions made at member meetings, and the ordinary governance and operating of the company. There was no deadlock in member meetings. There were disputes about the management of Outside Properties. When the court found “total dysfunction at the governance level,” it was referring to “issues concerning ordinary governance procedures and operating the Company,” as shown by the close context in which the references appear in the Ruling. (V.I.App. 298, Ruling.) This distinction between deadlock at member meetings and dysfunction in ordinary governance is important in assessing whether

the LLC is functional. In making that assessment, dislike and disagreement is not a deadlock. *See* 16A Fletcher Cyc. Corp. § 8066.10 ("[T]he profitable operation of a deadlocked corporation may warrant the dismissal of a dissolution proceeding. There must be a demonstrated inability to conduct the business of the corporation. Mere disagreement on how to conduct the business is not sufficient. Likewise, a shareholder's dislike of another shareholder does not create a corporate deadlock.").

C. The finding of dysfunction was insufficient to support the conclusion that it was not reasonably practicable to carry on the company's business in conformity with the articles of organization and the operating agreement

The Operating Agreement provided the means to navigate disagreements. In *Gagne v. Gagne*, relied upon by Joe, the Colorado Court of Appeals included as one of its factors for deciding reasonable practicability whether the operating agreement provided a means for navigating a deadlock. 338 P.3d 1152, 1156 (Colo. Ct. App. 2014). Here the Operating Agreement provided a means for resolving disagreements in ordinary governance by majority vote of members, and it also provided a means for resolving ties in the member vote. The court made the detailed findings about the voting procedures set forth in the Operating Agreement. (V.I.App. 272, Ruling.) "[T]he plain language of the Operating Agreement and the First Amendment to Operating Agreement directs that voting rights are to be one vote per voting member unless a demand is made with respect to a specific voting

issue, in which case each voting member is entitled to vote based on their proportionate share of total capital contributions." (V.I.App. 273, Ruling.) Disputes at the ordinary governance level can be resolved by votes of the membership. If necessary to break a two-two tie (which has never previously occurred) the parties can invoke the demand rule and vote their capital shares.

Under this voting protocol, membership votes need not be deadlocked. While Barkalow had dysfunctional relationships with others, he cannot cause a tie and thereby deadlock the meetings. As, Bryan testified, "things have been resolved as to how to run Outside Properties." (Vol.IV-43:6-10)

Joe points to one requirement in the operating agreement that requires unanimity: profit distribution. However, the members agreed to not distribute profits, at least until the debts were repaid. Vol.II-92:20-24. On this issue, the court is bound by the *Baur* decision to enforce the governing documents. The Iowa Supreme Court cited a plethora of authority on this issue, including the venerable Judge Easterbrook, and concluded: "As a minority shareholder and nonofficer, Jack will remain effectively precluded from capturing any return on his shareholder equity for as long as the board concludes income distributions are inappropriate." *Baur v. Baur Farms, Inc.*, 832 N.W.2d 663, 676 (Iowa 2013).

Joe also predicts, without citation to the record, that the members will not agree on future amendments to the Operating Agreement. This matter was not

brought up during trial and not considered or ruled upon by the court. There was no proposed amendment that would be necessary to operate the company.

Joe incorrectly stated that: "Since October 2017, the Company has not been operating pursuant to its Certificate of Organization and Operating Agreement, but rather pursuant to an Interim Management Agreement." There is no evidence that the interim agreement was a substitute for the Operating Agreement. (Joe's Brief at p.29). Quite the contrary: the Operating Agreement specifically provided that the Members could designate persons to act as managers and delegate responsibility to those designated managers. (V.I.App. 327, Ex 1 ¶ 5.1.) The Interim Management Agreement was in place "for the operations of Outside Properties" and was executed in 2017. (Vol.I-76:8-13.) Barkalow's entity, Big Ten Property Management, provided services which included placing tenants in, collecting rent from, and paying expenses for the Outside Properties rental units. (Vol.II-220:3-10.) Barkalow continued to manage the properties at the time of trial under the interim management agreement. (Vol.II-218:15-219:6.) Barkalow testified that if he continued to manage under that agreement, Outside Properties would continue to make profit. (Vol.II-219:3-6.)

Joe argued that: "the duty of good faith that each must bring to the Company will be nonexistent in the future." (Joe's Brief at p.40 (quoting Ruling p.37)). However, the Court also held that Bryan and Jeff fulfilled their duties of good faith

and loyalty when the Court dismissed Barkalow's claims for breaches of fiduciary duty. Barkalow's bad faith should not cause dissolution of the company under the minority oppression rule in *Baur*, as argued below.

D. Outside Properties was and is achieving the purposes that the parties established in the Certificate of Organization

The principal cases cited by Barkalow and Joe Clark engage in a functional analysis of whether the LLC operations can achieve the purpose of the LLC as stated in the governing documents. These cases provide persuasive authority for the proposition that reasonable practicability is determined in large part by whether the LLC is achieving the purposes stated in the governing documents.

Barkalow relies on *Kirksey v. Grohmann*, 754 N.W.2d 825 (S.D. 2008). In summarizing cases applying the "reasonably practicable" statute, the *Kirksey* court stated: "One approach, taken by several courts, is to examine the circumstances in light of the company's purpose and then determine if it is reasonably practicable to continue the business." *Id*. at 828 (underline added). The *Kirksey* court then took that approach quoting the operating agreement to ascertain the purpose. *Id*. at 830.

Joe relies on *Gagne v. Gagne*, 338 P.3d 1152, 1156 (Col. Ct. App. 2014). It that case the Colorado Court of Appeals focused on whether the company was unable to pursue the purposes for which it was formed. The *Gagne* court created and adopted a multi-factor approach to deciding whether it is reasonably practicable to carry on the business of a limited liability company, and the first

factor was whether the management of the entity is unable or unwilling reasonably to permit or promote the purposes for which the company was formed. *Id.* "[W]e… conclude that a limited liability company may be dissolved if a party seeking a judicial dissolution shows that the managers and members of the company are unable to pursue the purposes for which the company was formed in a reasonable, sensible, and feasible manner." *Id.* (underline added).

The stated purpose of Outside Properties is to invest in real estate holdings. The Certificate of Organization, signed by all four Members, clearly identified the purpose of Outside Properties:

> Purpose. That the purpose for which this limited liability company is organized is, primarily, to invest in real estate holdings and, secondarily, to engage in all lawful types of business, as from time to time determined by the members.

(V.I.App. 391, Ex. 36.)

Barkalow confirmed the above quoted statement was indeed the purpose of Outside Properties. Vol.II-93-94; Vol.II-115. Joe also confirmed that very same purpose. Vol.IV-144:3-11. Joe explained that the Clark family investment policy was to hold properties for the long-term, a philosophy that was about holding and not selling. Vol.IV-144:12-25.

The LLC successfully achieved its primary purpose of investing in real estate holdings. Barkalow admitted that the value of the real estate has increased.

Vol.II-218:3-5. Joe confirmed that Outside Properties has succeeded in its purpose because it has gone up in value, and that the value will remain at least where it is or continue to go up in value in the future if the real estate market remains the same. Vol.IV-145:11-146:7. The parties have used, in their appellate briefs, the significant appreciation in value of Outside Properties as evidence of the competing claims of windfalls. Outside Properties successfully functioned to achieve its primary purpose of being a real estate investment.

In addition to the primary purpose described in the previous point, Outside Properties also achieved the secondary purpose stated in the Certificate of Organization, "to engage in all lawful types of business." Outside Properties rented residential housing. That enterprise was also a success.

The company accountant testified that the last year before trial was the most profitable year that Outside Properties has had so far. Vol.III-86:3-15. Bryan testified, "it's been a profitable business all the way from its inception." Vol.IV-180:3-4. Barkalow agreed that, "[b]y every objective measure, Outside Properties continues to be a financial success." Vol.II-219:15-18.

E. It was error to dissolve the company based solely on the oppressive conduct of the minority member

The court found misconduct only by Barkalow. It found he engaged in self-dealing, breached his fiduciary duty and converted LLC assets to his own use. The court summarized: "It is fair to say that the evidence clearly shows that [Barkalow]

was a difficult partner." In commenting on the conversion claim that was granted against Barkalow, the court pointedly stated that "Conversion is the legal term used for theft." (V.I.App. 298, Ruling.)

Barkalow also strangled the Company's capital sources. Barkalow took the position that Outside Properties did not have to repay the Clark family loans because the loans were not memorialized in a written instrument: "No note, no mortgage, no payment." (V.I.App. 275, Ruling, ¶ 1.) Barkalow also obstructed Outside Properties attempts to borrow from their commercial lender. (V.I.App. 274, Ruling, ¶¶ 3-4.)

Conversely, the court denied Barkalow's various claims of misconduct against Jeff and Bryan. It found that the Clark brothers did not breach their fiduciary duties, engage in oppression, breach the implied covenant of good faith and fair dealing, engage in a civil conspiracy, breach a contract, or engage in civil extortion. (V.I.App. 281-288, Ruling.) Moreover, the court recited examples of good faith by Jeff and Bryan:

> [T]he Clark family entities loaned Tracy the money for his capital contribution; Jeff and Bryan never demanded payment from Tracy; Jeff and Bryan always allowed Tracy to vote with an equal share; the Clarks gave Tracy the opportunity to participate in the capital calls so that his share would not be diluted, but Tracy refused; the Clarks offered to either purchase Tracy's interest at an undiscounted amount or to take out commercial loans to repay their capital contribution and restore Tracy's 25% share, and he again declined.

(V.I.App. 282, Ruling.)

The only findings of misconduct were solely attributable to Barkalow. The court erred as a matter of law in dissolving the Company based upon a dysfunctional relationship, caused by the minority, where the Company was otherwise functioning as intended. To rule otherwise would give Barkalow, and all future minority LLC members, an absolute veto over the future of every LLC in Iowa. This is the situation that the *Baur* Court warned against. *See Baur*, 832 N.W.2d at 678 ("[C]ourts must be careful when determining relief to avoid giving the minority a foothold that is oppressive to the majority.").

Outside Properties was not deadlocked and was achieving its stated purposes by every objective measure despite the acrimonious relationship with Barkalow. The court erred in concluding that a dysfunctional relationship made it not reasonably practicable to carry on the Company's activities where the LLC was otherwise functioning in conformity with its governing documents.

II. CONVERSION OF CAPITAL TO LOANS: The Court acted without statutory or equitable authority in ordering the conversion of capital contributions into loans

The Appellants' Brief identified three limitations on a district court's authority: the statutory deference to the governing documents; the statutory exclusion of other remedies in cases based only on the 'not reasonably practicable'

standard; and the limitations on the equitable authority of the court. The Appellees addressed each of those points.

Note that the conversion-of-capital-to-loans issue is not even reached if the court does not have the statutory authority to dissolve the LLC in the first place. See *Baur*, 832 N.W.2d at 678 (requiring dismissal absent the finding of oppression required by statute).

A. The court erred by failing to give deference to the governing documents as required by the statute

Barkalow proposes that, once dissolution has been ordered under the statute, the court's equitable authority is no longer constrained by agreements of the parties as set forth in the governing documents. There is no authority for that proposition. There is nothing in the statutory regime that would support Barkalow's claim that the courts may disregard the parties' prior agreements.

Contrary to the Barkalow's argument, *Felt* held that courts are constrained to follow the operating agreement conditions for the dissolution of an LLC even where the statute provided an alternative. *Felt v. Felt*, No. 18-0710, 2019 WL 2372321 (Iowa Ct. App. June 5, 2019). At issue in that case was whether the company dissolved under the terms of a joinder agreement. The *Felt* court stated: "Because of the express nature of the joinder agreement requirement, we find it controls over the statutory provision deeming assent to the operating agreement through membership." *Id.* at *5. The *Felt* court concluded: "we are constrained to

construe the contract according to its terms" *Id.*at *7. This deference to the governing documents is consistent with the Iowa Code requirement that the operating agreement shall govern "[r]elations among the members as members[.]" Iowa Code § 489.110(1)(a).

While certain statutory requirements cannot be changed by the operating agreement (§ 489.110(3) (g-h)), the statute requires deference to the operating agreement on other issues. At issue here is whether the court has the authority to alter relations between the members or between the members and the LLC by converting capital contributions into loans. Because the court found the capital contributions the were made correctly and in accordance with the contract documents, the court is required, under § 489.110(1)(a), to defer to the agreements.

The *Maschmeier*[4] Court also expressed a preference for deference to the corporate organizing documents and it only exercised its equitable authority to set the stock price after finding that the documents were not adequate for that specific purpose. 435 N.W.2d at 382 ("We concur with this statement from the trial court's ruling: 'All parties have left the Court with the burden of evaluating the corporate stock.'").

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[4] Barkalow debates the authority of *Maschmeier v. Southside Press, Ltd.,* 435 N.W.2d 377 (Iowa Ct. App. 1988). Contrary to Barkalow's Brief, in the two published *Baur* opinions, the Iowa Court of Appeals and the Iowa Supreme Court cited to and quoted from *Maschmeier* opinion with approval on several different propositions. *Baur*, 780 N.W.2d 249 (Iowa Ct. App. 2010) (reversing summary judgment); *Baur,* 832 N.W.2d 663 (Iowa 2013) (reversing "directed verdict").

Maschmeier and *Baur* limit equitable authority in the context of the corporation statutes. Since equitable authority under the LLC statute is imported from corporation law, so too the limitations on that authority are imported.

B. The court erred by ordering a remedy other than dissolution where the statute specifically limits remedies in cases where the authority for dissolution is limited to the not reasonably practicable standard

Barkalow and Joe argue that the court possesses pre-existing equitable authority that was not specifically displaced by the statute. *Bauer* says otherwise. In *Bauer* the district court's equitable authority emanated from the statute. The authority to dissolve was based on the statute requiring proof that, "[t]he directors or those in control of the corporation have acted, are acting, or will act in a manner that is illegal, oppressive, or fraudulent." *Baur,* 832 N.W.2d at 670 (quoting Iowa Code § 490.1430(2)(b)). The court cited to the statute as the basis for the equity court's considerable flexibility in resolving the dispute. *Id.* at 677. The court concluded that, if no oppression has been demonstrated, the action "shall be dismissed." *Id.* at 678. In cases brought under that statute, the court had no equitable authority absent a finding of oppression required by statute.

The same interplay between statutory authority and equitable authority should apply to cases brought under the LLC statute. That statute states in pertinent part:

> 1. A limited liability company is dissolved, and its activities must be wound up, upon the occurrence of any of the following:

> ….
> d. On application by a member, the entry by a District Court of an order dissolving the company on the grounds that any of the following applies:
> (1) The conduct of all or substantially all of the company's activities is unlawful.
> (2) It is not reasonably practicable to carry on the company's activities in conformity with the certificate of organization and the operating agreement.
> e. On application by a member or transferee, the entry by a District Court of an order dissolving the company on the grounds that the managers or those members in control of the company have done any of the following:
> (1) Have acted, are acting, or will act in a manner that is illegal or fraudulent.
> (2) Have acted or are acting in a manner that is oppressive and was, is, or will be directly harmful to the applicant.
> **2. In a proceeding brought under subsection 1, paragraph "e", the court may order a remedy other than dissolution.**

Iowa Code § 489.701 (emphasis added).

By limiting "a remedy other than dissolution" to section (1)(e), the legislature specifically excluded the authority to order a remedy other than dissolution in proceedings brought under section (1)(d). There is no other way to give meaning to the words that are present in § 489.701(2). Absent a showing of illegality, fraud or oppression, the court's authority to fashion a remedy is limited to dissolution; it does not have leeway to create an equitable remedy where the statute specifically states there is no remedy other than dissolution. This interpretation is consistent with the *Baur* holding recited above.

Barkalow cites New York cases applying a New York statute. However, that foreign statute does NOT contain the limitation on remedies that is present in the Iowa statute. The New York statute states in its entirety:

> On application by or for a member, the supreme court in the judicial district in which the office of the limited liability company is located may decree dissolution of a limited liability company whenever it is not reasonably practicable to carry on the business in conformity with the articles of organization or operating agreement. A certified copy of the order of dissolution shall be filed by the applicant with the department of state within thirty days of its issuance.

NY Limit Liab Co § 702 (McKinney). There is no analog in the New York statute to Iowa Code § 489.701(1)(e) or (2). Therefore, the cases referring to the New York statute can provide no assistance in the interpretation of the Iowa statute.

It was an error by the court to convert capital contributions to loans, because the court's remedy limited to dissolution where the dissolution is founded on reasonable impracticability.

C. The court erred in exercising equitable authority where the only wrong to be righted was the wrong caused by Barkalow

As set forth above, the court found that Barkalow was a difficult partner who engaged self-dealing, civil conversion a/k/a theft, and he breached his fiduciary duties. Barkalow's conduct directly led to the Clark brothers' decision to make capital contributions instead of loans.

The court found that Barkalow voted twice to NOT repay the Clark family loans that had been used to capitalize the LLC. (V.I.App. 275, Ruling, ¶ 1.)

Barkalow claimed that the loans were not memorialized with a written instrument and stated several times: "no note, no mortgage, no payment." *Id*. Consequently, Outside Properties quit making payments on the Clark family loans in September 2014. *Id*. This conduct alone was oppressive.

In the spring of 2015, the members agreed that Joe would look into refinancing the Clark family loans to Outside Properties, "but [Barkalow] stopped the refinancing." (V.I.App. 275, Ruling, ¶¶ 2-4.) Although three members voted for commercial refinancing of the family loans, the bank would not make a loan if just one member objected, so Barkalow single-handedly blocked commercial lending sources. (V.I.App. 275, Ruling, ¶ 5.) It was at that point that Jeff and Bryan first advocated using capital contributions to pay the family loans. (V.I.App. 275-276, Ruling, ¶ 5.)

The court found: "[Barkalow]'s actions preventing the Clark family loans from being refinanced through US Bank in the summer of 2015 hindered the progress of getting the Shultz loan taken care of with a bank loan in December 2015." (V.I.App. 274, Ruling.) Hence, Barkalow's past obstruction of loans from commercial sources, and his obstruction of the repayment of the loans from the Clark family led directly to the vote by Jeff, Bryan and Joe to treat the December 2015 infusion as a capital contribution instead of loan. *Id*. Barkalow's refusal to

acknowledge repayment obligations on the Clark family loans led to the second capital contribution in February 2016. (V.I.App. 275-276, Ruling.)

Joe makes claims about what is "fair and equitable." Joe's equity arguments miss the point because they do not identify any findings by the court of "a circumstance contrary to the principles of equity." Moreover, there are two fundamental contradictions with all of Joe's arguments about what is fair and equitable. First, Joe voted for both capital contributions. Joe testified about the 2015 capital contribution: "Nobody voted for it to be a loan; we voted for it to be a capital contribution." (Vol.IV-143:17-18.) He testified about the 2016 capital contribution: "I voted in favor of it, so I suppose at some point there was an obligation to put money in." (Vol.IV-132:14-15). At the time the votes were taken, and recorded in the minutes of the membership meetings, Joe presumably thought the capital contributions were fair and equitable.

Second, Joe testified that the capital contributions were based on legitimate business purposes. Joe testified that the 2015 capital contribution was in the best interest of the company, "to get Ellis paid off." (Vol.IV-88:15-18.) Joe testified that the 2016 capital contribution was in the best interest of Outside Properties to

pay the loans from Clark family entities (payments that Barkalow opposed) because "that's how a good business is run."[5] (Vol.IV-130:15-131:24.)

Tangentially, Joe states that the statutory provision for winding up a dissolved LLC will require distribution of surplus in "equal shares" to each member. However, that rule is only a default rule and the parties are free to arrange a different distribution in the governing documents. *See* Unif.Ltd.Liability Co.Act 2006 § 708 Comment (Westlaw); 5 Ia. Prac., Business Organizations § 13.25, M. Dore (Westlaw 2020).

Here the Operating Agreement (V.I.App. 325, Ex. 1, ¶ 2.7.1) and the Certificates of Management (V.I.App. 462-468, Exs. 319-322) each reflect the intent of the parties to tie capital accounts to equity. Indeed the corporate tax return K-1's from 2009 to 2015, all consistently show that the parties allocated annual profits and losses to capital accounts based on the percentage of capital. (V.II.App. 232-612, Confidential Exs. 312-318, Vol.I-170:11-171:4; Vol.III-182:3-16.) Joe's suggestion that the statute will ultimately require distribution of the surplus in equal shares is legally and factually incorrect, and it is not responsive to any point raised on appeal.

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[5] Joe complains that the 2016 capital contributions were used to pay loans that were neither due nor in default, and no member vote was taken to establish a due date for the contribution. This argument goes only to the timing of the contribution, not to its essential nature.

III. CROSS-APPEAL: The cross-appeal is without merit because the court properly denied dissolution based on oppression by the Clarks where Barkalow was the oppressor and the Clarks breached no fiduciary duties

Bryan and Jeff agree that error was preserved and that this Court reviews this issue de novo.

A. The court correctly denied Barkalow's claim of oppression

Barkalow appeals the denial of dissolution based on alleged majority-member oppression, but does not dispute the legal findings.

1. Barkalow failed to prove oppression based on his reasonable expectations.

Barkalow's appeal depends entirely on his claimed expectation that there would be no "required" capital contributions. Barkalow claims that the phrase "no additional capital contributions shall be required," means that no capital contributions shall be permitted at all, or perhaps only in circumstances that Barkalow does not fully articulate. "[N]othing in the Operating Agreement allows for (i) unilaterally capital contributions; or (ii) a member making demand of another to make an equal capital contribution or face dilution of his ownership interest." (Barkalow's Brief p.53). Barkalow thus implies that capital contributions are permitted in some circumstances, either where they are not made "unilaterally," or do not cause dilution. None of those expectations is reasonable.

The Operating Agreement stated that the capital proportions were to be "adjusted from time to time to reflect any additional contributions or withdrawals." (V.I.App. 270, Ruling.) The Company's Management Certificates also state "that capital contribution and proportionate equity interest is subject to change." (V.I.App. 462, Ex. 319). Barkalow signed both and so they are an objective source of his reasonable expectations (V.I.App. 328, Ex. 1; V.I.App. 462, Ex. 319.) Barkalow reasonably should have known that additional contributions could be made.

Barkalow's "no dilution" condition for additional contributions is objectively unreasonable. The above-quoted provision of the Operating Agreement provides for an adjustment in the voting rights "in proportion to the capital contributions of each member, as adjusted from time to time to reflect any additional contributions or withdraws." (V.I.App. 328, Ex. 1). The Company's Management Certificates provides that that "proportionate equity interest is subject to change."

Barkalow's "no unilateral contributions" condition is also objectively unreasonable. It is not clear what Barkalow means by the term "unilateral." He implies that there has to be unanimity because he uses of the term "unilateral" to describe the two contributions that were authorized by a majority vote of 3 to 1.

Neither the Operating Agreement nor the statute require unanimity. The Operating Agreement does not create a separate voting procedure for capital contributions and it does not require unanimity. Barkalow's reasonable expectation was that of a minority member. (V.I.App. 281, Ruling.) As such, Barkalow had to expect that the will of the majority would prevail at votes taken at member meetings.

The statute defines contribution to include "…any benefit provided by a person to a limited liability company that is… (c) In the person's capacity as a member and in accordance with the operating agreement or an agreement between the member and the company." Iowa Code § 489.102. Thus, the statute permits the company to reach an agreement with a member to make a contribution without a requirement of unanimity.

As long as contributions were permissive and not required, the reasonable expectation was that a majority could vote to add capital. The court correctly found that Barkalow was offered the opportunity to contribute capital and declined. Barkalow chose to invest in other opportunities rather than contribute to Outside Properties. (V.I.App. 279, Ruling.). This precludes Barkalow's claim of oppressive conduct as a matter of law. "[D]ilution of the value of the minority shareholder's stock <u>will not amount to oppressive conduct</u> when the minority shareholder is given an opportunity to supply capital and thereby maintain its

percentage interest in the corporation." *In re Quail Aero Serv., Inc.,* 300 A.D.2d 800, 802 (N.Y. App. Div. 2002) (citing *DiPace v. Figueroa*, 223 A.D.2d 949, 952 (N.Y. App. Div. 1996)). *See Knobloch v. Home Warranty, Inc.,* C15-4239-MWB, 2016 WL 6662709, at *1–7 (N.D. Iowa Nov. 10, 2016).

2. Barkalow failed to prove the capital contributions were not supported by a legitimate business purpose

Barkalow argues that the court erred in finding the capital calls were supported by a legitimate business purpose. (Barkalow's Brief pp.56-63). Barkalow acknowledges that the capital contributions were used to pay debts to Ellis Shultz in 2015 and to the Clark family entities in 2016. Barkalow argues that payment of debt was not legitimate purpose because Outside Properties could have borrowed the money from a commercial lender or from the Clark family entities.

However, Barkalow obstructed the repayment to the Clark family loans, as recited above. For that reason, Outside Properties stopped making payments on the Clark entity loans in September 2014. (Vol.VI-159:10-160:1.) Joe, Bryan, and Jeff were all willing to refinance the Clark entity loans with US Bank, but Barkalow stopped the process. (Vol.IV-85:8-86:18; V.II.App. 210, Ex. 118.) *See also* Vol.IV-159:1-10; Vol.III-114-118 (discussing Ex. 34 vote to pay off interfamily loans; Jeff testifying Tracy said wouldn't repay without note and mortgage); (Vol.III-185:23-186:3 (Tracy was one who refused to agree to US Bank financing, which required approval by all 4 members per bank policies) (Vol.IV-

85:8-86:18.) The court properly concluded that [Barkalow]'s actions of preventing the Clark family loans from being refinanced through US Bank in the summer of 2015 hindered the progress of getting the Ellis Shultz loan taken care of with a bank loan in December 2015. (V.I.App. 274, Ruling.)

Barkalow's obstruction of commercial refinancing continued at meetings in January and February of 2016. At each, Barkalow's "no" vote resulted in a barrier to refinancing with US Bank or another third party entity. (*See* V.I.App, 404-405, Ex. 42, Votes 2 and 3; V.I.App. 406, Ex. 43; Vol.IV-97:1-97:23).

The evidence showed and the court correctly found that it was Barkalow's own obstruction of commercial lending sources and his objection to the repayment of the Clark family loans that created the legitimate business need for capital contributions.

B. The court correctly found that the Clark brothers did not breach a fiduciary duty

Bryan and Jeff agree that Barkalow preserved error and his statements regarding the standard of review on this issue.

For his fiduciary duty claim, Barkalow relies on the same facts as his claim of oppression: the Clarks frustrated the reasonable expectations of Barkalow to not be required to contribute additional capital and not have his ownership interest

diluted. (Barkalow's Brief p.64). For the same reasons that Barkalow failed to substantiate his claim of oppression he cannot establish a breach of fiduciary duty.

In addition, Barkalow failed to provide evidence of his damages under the proper methodology required by the Supreme Court. *See Baur*, 2016 WL 4036105, at *4-5 (affirming the court's conclusion that majority shareholders' refusal to buy out minority shareholder's interest at an amount that failed to consider tax implications and liquidation value of interest was not oppressive). When oppression is shown, and a minority member is allowed to withdraw, the Supreme Court has made clear his interest must discounted for minority interest and tax implications. Barkalow's expert did not provide that valuation, only valuing his full valuation if the contributions are treated as loans rather than equity.

For all of these reasons, the court properly determined that the Clarks did not breach their fiduciary duties. That part of the decision should be affirmed.

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